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In the Supreme Court
OF THE
United States

OCTOBER TERM, 1974

No. 74-758

PROVIDENT SECURITIES COMPANY, a California corporation,
Cross-Petitioner,

vs.

FOREMOST-McKESSON, INC., a Maryland corporation,
Cross-Respondent.

CONDITIONAL CROSS-PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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Cross-petitioner Provident Securities Company (hereinafter "Provident") has been advised that Foremost-McKesson, Inc. (hereinafter "Foremost") intends to file a petition for a writ of certiorari to review the judgment and the opinion of the United States Court of Appeals for the Ninth Circuit entered in this proceeding on September 19, 1974. Although the Ninth Circuit affirmed the judgment of the district court in favor of Provident, it

disagreed with the district court's opinion and it rejected or did not consider some other points raised by Provident on the appeal. As we shall discuss in our opposition to Foremost's petition, we believe that the opinion of the Court of Appeals is correct with respect to its reasons for affirming the judgment and that therefore the petition should be denied. However, if this Court should determine to grant Foremost's petition for a writ of certiorari, Provident will wish to present all its arguments to this Court. This conditional cross-petition for a writ of certiorari is filed to avoid any question as to its right to do so.[1]

OPINIONS BELOW

The opinion of the district court (Appendix A hereto) is reported at 331 F.Supp. 787. The opinion of the Court of Appeals (Appendix B hereto) is unofficially reported at CCH Federal Securities Law Reporter, ¶94,811 (p. 96,703).

JURISDICTION

The judgment of the Court of Appeals was entered on September 19, 1974. No petition for rehearing was filed. This Court has jurisdiction under 28 U.S.C. § 1254(1).

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[1]Because the Court of Appeals affirmed the judgment in favor of Provident, we believe that if Foremost's petition were to be granted it would be appropriate for Provident to raise grounds in support of the judgment, including those rejected or not considered in the opinion below (*Stelos Co. v. Hosiery Corp.* (1935) 295 U.S. 237, 239; *Langnes v. Green* (1931) 282 U.S. 531, 535). This cross-petition is filed as a precautionary measure in order to avoid any doubt as to Provident's right to raise those grounds.

QUESTIONS PRESENTED

All questions presented in this cross-petition involve interpretation and application of § 16(b) of the Securities Exchange Act of 1934 (48 Stat. 896, 15 U.S.C. § 78p(b)). Those questions are:

1. Does the potential for actual speculative abuse test enunciated in this Court's opinion in *Kern County Land Co. v. Occidental Corp.* (1973) 411 U.S. 582 apply to an exchange of assets for securities, in which exchange no cash was paid for the securities and the recipient of the securities wished only to receive cash for its assets?

2. Does there exist a potential for actual speculative abuse when a corporation, which is liquidating by selling its holdings and thereafter distributing its assets to its shareholders, has no access to inside information with respect to the purchaser of its assets and receives its purchaser's securities—shortly thereafter sold as a part of the liquidation—solely as an accommodation to the purchaser?

3. When, under an underwriting agreement, a seller of securities retains possession and the incidents of ownership and cannot benefit from a rising market and is not insulated from a falling one, is the date of the sale the date of the underwriting agreement or the actual date of transfer of the securities and relinquishment of the incidents of ownership?

4. Under a plan of complete corporate liquidation pursuant to state law, may the corporate legal owner of securities be divested of beneficial ownership and its shareholders vested with such beneficial ownership so that

§ 16(b) will apply to transactions by those beneficial owners and not by the legal owner?

5. Under a plan of complete corporate liquidation pursuant to state law, may a corporate legal owner of securities become a liquidating agent or other similar person authorized to administer the assets of its shareholders so as to render any sale of the assets exempt from § 16(b) under Securities and Exchange Commission Rule 16a-4 (17 C.F.R. § 240.16a-4)?

STATUTES AND REGULATIONS INVOLVED

The sections of the Securities Exchange Act of 1934 (48 Stat. 881, 15 U.S.C. §§ 78a, et seq.) involved in this case are §§ 3a(13), 3a(14), 16(a) and 16(b). Also involved is Securities and Exchange Commission Rule 16a-4 (17 C.F.R. § 240.16a-4) and sections of the California Corporations Code. Those sections are reproduced in Appendix C hereto.

STATEMENT OF THE CASE

A. The proceedings below.

Provident filed this action seeking a declaration of nonliability. Foremost counterclaimed seeking a declaration of liability and recovery of asserted profits. Both parties moved for summary judgment and the district court gave judgment for Provident, holding that the transaction did not involve a potential for speculative abuse of inside information (Appendix A, pp. viii-xi).

On appeal by Foremost, the Court of Appeals affirmed but on other grounds. It held (Appendix B, pp. xiv-xix) that the potential for speculative abuse test was not applicable because the transaction was "essentially a cash-for-stock transaction" and that, in any event, there did exist a potential for speculative abuse. It also rejected (Appendix B, pp. xix-xxii) Provident's argument that the date of sale fell after such time that Provident had become a holder of less than 10% of any equity security of Foremost. It affirmed the judgment (Appendix B, pp. xxii-xl) because Provident had not owned any Foremost securities when it entered into the transaction here in question and therefore was not a "beneficial owner" of "more than 10 per centum of any class" of Foremost securities "at the time of the purchase" (15 U.S.C. § 78p(a), (b)).

B. The facts.

The basic facts of this case are undisputed:

Provident, now dissolved, was a personal holding company incorporated under the laws of California for the purpose of managing various assets for the benefit of its shareholders (R.,[2] p. 391). In late 1968, Provident tentatively decided to liquidate and to distribute its assets, or the proceeds from a sale thereof, pro rata to its shareholders (R., p. 391). After investigation of various proposals, Provident decided to pursue negotiations on a proposal under which Foremost would purchase most of Provident's assets (R., p. 392). Extensive negotiations followed between Provident and Foremost regarding the form of the transaction and the nature of the considera-

[2]The clerk's record in the court below is cited herein as "R., p. ....."

tion to be paid. During these negotiations, Foremost had full access to Provident's books and records and Foremost made a complete appraisal of all of Provident's assets (R., pp. 251-252).

To facilitate liquidation and dissolution, Provident was interested in selling to Foremost for cash (R., p. 392). Foremost, however, insisted that the major portion of the purchase price should be in securities of Foremost to be issued expressly for that purpose (R., p. 392). Although Provident argued that Foremost should sell securities itself if it wanted to use them to finance the purchase of Provident's assets, Foremost remained adamant on this point (R., p. 392). Compromise eventually was reached under which Foremost agreed to take such steps as were necessary to accommodate the sale, as promptly as possible following the closing of the purchase, of one half of the securities to be transferred to Provident (R., pp. 392-393).

The purchase agreement provided that Foremost would purchase approximately two thirds of Provident's assets in exchange for cash and Foremost convertible subordinated debentures which were to be issued expressly for the purpose of acquiring Provident's assets (R., pp. 393, 411-451). It also provided that, following the closing of the agreement, Provident could distribute to its shareholders, as part of its plan of liquidation and dissolution, the Foremost debentures delivered pursuant to the purchase agreement (R., p. 393). The debentures, however, would not be marketable without the prior written consent of Foremost unless registered under the Securities Act (R., p. 418).

With respect to the debentures which were to be sold by Provident's shareholders after the distribution, Foremost agreed to use its best efforts to file a registration statement as soon as practicable after the date of the agreement (R., pp. 393-394, 418-419). Foremost also agreed to enter into an underwriting agreement whereby those debentures would be sold to the public (R., pp. 394, 418-419).

On September 26, 1969, the Provident Board of Directors recommended dissolution and additionally recommended ratification of the purchase agreement executed the previous day (R., pp. 395, 499-500). At a shareholders' meeting later the same day, Provident's shareholders elected to dissolve and a plan of complete liquidation was adopted (R., pp. 395, 501-510). The agreement was then approved by the shareholders (ibid.).

The Form S-1 registration statement, filed by Foremost with the Securities and Exchange Commission on September 29, 1969, anticipated that the offering would be made by the Provident shareholders who were to receive the debentures in a liquidating distribution by Provident (R., pp. 394, 530, 536). Early in October, 1969, however, difficulties were encountered with respect to the proposed public offering by Provident's shareholders (R., p. 397). In particular, it was impossible to get consents to sell from the minor shareholders without the appointment of guardians; in addition, one shareholder was somewhere in the Brazilian jungles and could not be contacted (R., pp. 397-398). To resolve this problem, Foremost agreed to a change in the Purchase Agreement so that Provident,

instead of its shareholders, might sell the debentures (R., pp. 269, 398-399, 688-702).

At a meeting on October 13, 1969, the Provident Board of Directors declared the first liquidating dividends, directing distribution of all of Provident's assets "pro rata to shareholders of record * * * as expeditiously as possible" (R., pp. 396-397, 680).

At the closing of the agreement on October 15, 1969, Foremost delivered a check and debentures to Provident (R., p. 399). Prior to receipt of the debentures, Provident had no legal or beneficial ownership in any security of Foremost (R., p. 391). On October 20, Provident instructed the First National City Bank, as trustee, to distribute pro rata to Provident's shareholders the debentures which were not to be sold (R., pp. 399-400). The actual mailing of those debentures took place on October 24, 1969 (R., p. 400).

On October 21, 1969, an underwriting agreement covering the remaining debentures was executed by Foremost, Provident and the underwriters (R., pp. 400, 707-719). That agreement defined "the time of purchase" as "9:45 A.M., on October 28, 1969" and provided that Provident would deliver the debentures and receive payment at that time (R., pp. 707-708).

Later on the same day that the underwriting agreement was signed (October 21), an amended S-1 registration form filed by Foremost covering those debentures became effective (R., pp. 628-678; Foremost Opening Brief, p. 23). That form had been amended to provide that the sale would be made through Provident and that "the proceeds of the sale of the Debentures offered hereby and the re-

maining Debentures issued or to be issued to Provident will be distributed by Provident to its shareholders in a liquidating distribution" (R., p. 643).

At the closing on October 28, the underwriters delivered $25,366,666.66 to Provident through New York clearing house funds, and Provident delivered the debentures in the principal amount of $25,000,000 to the underwriters (R., p. 400). After waiting the necessary 24 hours for the check drawn on the New York clearing house funds to clear, Provident distributed the cash to its shareholders (R., p. 400).

Liquidation proceedings continued throughout late 1969 and 1970 (R., pp. 400-401). On August 31, 1970, Provident was declared dissolved by court order and its remaining assets were transferred to a liquidating trust (R., pp. 401, 726-739).

REASONS FOR GRANTING WRIT

As discussed above (supra, pp. 1-2), the Court of Appeals affirmed the judgment in favor of Provident but, in doing so, it rejected some of Provident's arguments and did not consider others. Provident has filed this cross-petition for a writ of certiorari solely as a precautionary measure because it has been advised that Foremost intends to file a petition for a writ of certiorari.

Inasmuch as the Court of Appeals correctly affirmed the judgment (as we shall show in our opposition to Foremost's petition for a writ of certiorari) and inasmuch as the questions discussed herein involve matters either mis-

understood or ignored in the court's opinion, the questions presented might not be sufficiently important to justify an independent petition for a writ of certiorari. However, if this Court should grant Foremost's petition, we submit that it should review the entire case.

I. AN EXCHANGE OF ASSETS FOR STOCK IS AN "UNORTHODOX" TRANSACTION WHICH SHOULD BE EXAMINED FOR A POTENTIAL FOR ACTUAL SPECULATIVE ABUSE.

This Court, in holding that "certain 'unorthodox' transactions" might not be subject to § 16(b), has noted that "traditional cash-for-stock transactions that result in a purchase and sale or a sale and purchase within the six-month, statutory period are clearly within the purview of § 16 (b)" *(Kern County Land Co. v. Occidental Corp.* (1973) 411 U.S. 582, 593). The Ninth Circuit erroneously stated that it was not necessary to examine the transaction herein for a potential for speculative abuse because it viewed that transaction as "*essentially* a cash-for-stock transaction" (Appendix B, p. xvi; emphasis added).

Despite the Ninth Circuit's characterization, the transaction herein was *not* an exchange of cash for stock; it involved an exchange of assets for cash and securities. In effect, Provident was merged into Foremost and it received cash and Foremost debentures as consideration in that merger. Professor Loss has noted that an "unorthodox" transaction may be involved in "the acquisition of securities of one company in exchange for the assets of another" (Loss, Securities Regulation (Supp.2d Ed. 1969) Vol. 5, p. 3029). Similarly, in *Kern,* this Court noted that

"unorthodox" transactions would include "exchanges pursuant to mergers or other corporate reorganizations" (411 U.S. 593, ftn. 24).

Provident had not entered the market with cash seeking to purchase securities. Instead, Provident's sole motivation was to dispose of its assets in exchange for cash which was to be distributed to its shareholders in the liquidation. It is undisputed, as the district court pointed out, that Provident did not want any Foremost stock and that it accepted the debentures only because of Foremost's insistence (Appendix A, pp. ii-iii, xi). There thus exists a quite meaningful distinction between this transaction and a traditional cash-for-stock transaction. That distinction pertains to the manner of acquisition. If a cash purchase is involved, then there may be a reasonable presumption that the purchaser wanted to acquire the stock which he purchased and that he may have intended to engage in speculation with that stock. If there is no cash involved, then there may not have been any wish to acquire the stock and, accordingly, no intent to speculate.

Therefore, the transaction should be examined to determine whether it involved a potential for actual speculative abuse. We submit that the court below erred in its characterization of the transaction and in its conclusion that the potential for speculative abuse should not be examined.

II. THE TRANSACTION INVOLVED NO POTENTIAL FOR ACTUAL SPECULATIVE ABUSE.

As discussed above, the Ninth Circuit determined that the transaction should not be examined for a potential for speculative abuse and that § 16(b) was automatically applicable to it. Nonetheless, the court did examine the transaction and, in doing so, it considered two factors:

> "(1) Could [Provident] reasonably be expected to have had access to inside information? And (2) did [Provident] initiate the transaction voluntarily?" (Appendix B, p. xvii).

The Court of Appeals erred in its discussion of the matters pertinent to both these inquiries.

First, the Ninth Circuit correctly noted that the presumption of access to inside information could be rebutted (Appendix B, p. xviii). However, it erroneously held that Provident had not rebutted that presumption because it had "not demonstrated that the Foremost management was hostile" (Appendix B, p. xviii). In *Kern*, this Court examined the facts to ascertain whether "Occidental either had or was likely to have access to inside information, by reason of its ownership of more than 10% of the outstanding shares of Old Kern, so as to afford it an opportunity to reap speculative, short-swing profits" (411 U.S. 596). From the *fact* that Old Kern's management was hostile, this Court *inferred* that the likelihood of possession of inside information was remote (411 U.S. 598).

Plainly, if the presumption of access to inside information can be rebutted by such an inference, it can also be rebutted by other facts. Here, it is undisputed that the negotiations between the parties related solely to the

evaluation of *Provident's assets* which were to be transferred to Foremost. During that time, it was Foremost that had complete access to Provident's books and records (R., pp. 251-252) but there was no reason for Provident to have, and it did not have, any access to Foremost's books and records. There has therefore never been any contention that Provident's brief status as an "insider" gave it any access to inside information (Appendix A, p. ix).

Second, the Ninth Circuit's emphasis on the "voluntary" nature of the transaction was misplaced. In *Kern,* involuntariness was again a *fact* involved in the stock conversion transaction. However, the voluntary nature of the transaction is not necessarily a controlling factor. This is made clear by the portion of this Court's opinion which discussed the subsequent stock option transaction—a wholly voluntary transaction—and concluded that there was no potential for speculative abuse in that transaction (411 U.S. 601-604). This view is consistent with that of the Second Circuit which has previously pointed out that the voluntary nature of a transaction is not determinative (*Blau v. Lamb* (2 Cir. 1966) 363 F.2d 507, 520).

As in *Kern,* Provident had no prior association with Foremost and owned no Foremost securities before its acquisition of the debentures. Therefore, Provident could not be found liable because of any hypothetical speculative calculations prior to the acquisition because any such calculations "could not have been based on inside information obtained from substantial stockholdings that did not yet exist" (411 U.S. 597). Also, as in *Kern,* there was no access to information after the acquisition. The court

below therefore erred in its conclusion that there existed a potential for speculative abuse.

III. THE SALE OF THE DEBENTURES OCCURRED WHEN PROVIDENT WAS NOT AN OWNER OF 10% OR MORE OF A CLASS OF FOREMOST'S SECURITIES.

The underwriting agreement was signed on October 21, 1969 (R., pp. 400, 707-719) and it provided that October 28 was to be "the time of purchase" when Provident would deliver the debentures and receive payment (R., pp. 707-708). On October 24, 1969, Provident distributed to its shareholders other Foremost debentures held by it so that, as Foremost conceded in the proceedings below, the remaining debentures to be sold constituted "less than 10% of the class of outstanding common stock" (Foremost Opening Brief, p. 23). At the closing on October 28, the remaining debentures were transferred to the underwriters and Provident received its payment (R., p. 400). Because possession and the incidents of ownership were not transferred until October 28, that date should be considered the date of sale (*Champion Home Builders Co. v. Jeffress* (6 Cir. 1974) 490 F.2d 611, 616). On October 28, Provident was not an owner of 10% or more of a class of Foremost's securities and § 16(b) liability therefore could not attach (15 U.S.C. § 78p(b); *Reliance Electric Co. v. Emerson Electric Co.* (1972) 404 U.S. 418, 423-425).

The Court of Appeals, however, erroneously held that October 21 was the date of sale because on that date, in its view, Provident was "irrevocably bound" to sell (Appen-

dix B, p. xxi). Because of its mistaken belief that Provident had insulated itself against all market risks (Appendix B, p. xxi), the court ignored the rule that a firm commitment, standing alone, does not necessarily give rise to a purchase or sale under § 16(b) (*Champion Home Builders Co. v. Jeffress* (6 Cir. 1974) 490 F.2d 611, 616).

The court below made reference only to paragraph 7 of the underwriting agreement which permitted termination under certain adverse conditions until such time as the registration statement became effective. The statement became effective on October 21 and the court concluded that therefore the agreement was not subject to termination after that date. In reaching that conclusion, the court overlooked the fact that, under paragraph 5(h), the agreement was subject to the express condition

> "That, between the time of execution of this agreement [October 21] and the time of purchase [October 28], there shall occur no material and unfavorable change, financial or otherwise (other than as referred to in the Registration Statement and the Prospectus), in the condition of the Company [Foremost] and its consolidated subsidiaries as a whole * * *" (R., p. 713).

Therefore, Provident could not have obtained speculative advantage through the October 21 agreement. Provident could not share in a rising market and, because the agreement was terminable under adverse conditions, it was not insulated from a falling one. Possession and ownership rights were not transferred until October 28 and that, accordingly, was the date of sale (cf. *Kern County Land Co. v. Occidental Corp.* (1973) 411 U.S. 582, 602).

IV. PROVIDENT HELD THE FOREMOST DEBENTURES SOLELY FOR THE BENEFIT OF ITS SHAREHOLDERS AND THEREFORE THE TRANSACTION WAS NOT SUBJECT TO § 16(b).

This case also involves certain questions pertaining to "beneficial ownership" which were not considered in the opinions below. The record demonstrates that at all pertinent times Provident was acting solely for the benefit of its shareholders. A plan of complete liquidation had been approved *prior* to the acquisition of the Foremost debentures. Under California law, this required Provident to cease all business other than "beneficial winding up" and also required distribution of all assets to the shareholders (Cal.Corp.Code §§ 4600, 4605, 5000).

We submit that, under these circumstances, § 16(b) was not applicable to the sale of the Foremost debentures because Provident's shareholders, not Provident, were in fact and in law the beneficial owners of those debentures. We also submit that Provident had become a liquidating agent or other similar person authorized by California law to administer the assets of its shareholders, rendering the transaction exempt under Securities and Exchange Commission Rule 16a-4 (17 C.F.R. § 240.16a-4).

We have not presented here all the factual detail pertaining to these points. If, however, this Court should take up this case, we expect to argue these points in full.

CONCLUSION

For the foregoing reasons, we respectfully submit that in the event that the Court should grant Foremost's petition for a writ of certiorari in this case, this cross-petition should likewise be granted.

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(Appendices Follow)